INDEX.

	Page
CITATIONS TO OPINIONS BELOW	2
JURISDICTION	2
QUESTIONS PRESENTED	2
STATEMENT OF THE CASE	4
REASONS FOR GRANTING THE WRIT	8
A. Section 167 of the Bankruptcy Act Does Not Authorize the District Court to Allow Any Party, Other Than a Trustee Who Cannot Delegate Such Duty, to Conduct an Examination of Officers and Directors of the Debtor Corporation	9
B. Assuming, *Arguendo*, the District Court Has Such Discretion, the District Court Abused That Discretion Since the Commission Under the Federal Securities Laws Was and Is Presently Conducting a Non-Public Investigation of the Debtor Corporations to Ascertain Whether Criminal Violations of Such Laws Have Occurred	12
1. Once the Commission has determined to conduct a non-public rather than public investigation of a corporation, it cannot participate directly or indirectly in a public examination of such corporation until such time that the Commission authorizes a public investigation	12
C. Assuming, *Arguendo*, the District Court Has Such Discretion, the District Court Abused That Discretion	15
1. Since appellant has already testified in the non-public investigation and is subject to criminal prosecution, the Commission should not be allowed to again examine him in a public examination without affording him the rights and protection to which appellant is entitled by law under a public investigation conducted by the Commission	15

INDEX (Continued).

Page

2. The purpose of a Section 167 examination is to evaluate the desirability of the continuance of the Debtor's business and/or to formulate a plan of reorganization, not as the Commission intends, to determine whether appellant has violated Federal Securities Laws 16

3. Since the Trustees have already admitted that the Commission is cooperating with them and appellant has alleged and the Commission has not denied that the Commission has divulged, and in the course of a Section 167 examination, necessarily will divulge to unauthorized persons, including the Trustees, confidential information, documents and lines of inquiry, obtained by the Commission in its non-public investigation, the divulgence of which is contrary to law, the Commission should not be allowed to participate in the pubic examination of appellant 16

CONCLUSION 17

APPENDIX

Opinion (Court of Appeals, Third Circuit) 1a

Order Sur Petition for Rehearing (Court of Appeals, Third Circuit) 4a

Judgment (Court of Appeals, Third Circuit) 5a

Opinion (District Court, E. D. Pa.) 6a

TABLE OF CITATIONS.

Cases: Page

Elmo Division of Drixe-X Company v. Dixon, 348 F. 2d 342 (D. C. Cir. 1965) 15

R. H. Macy & Company, Inc. v. Tinley, 249 F. Supp. 778 (D. D. C. 1966) 15

Authorities:

Collier on Bankruptcy, Vol. 6, 14th Ed.:

Para. 0.08(3) 10

Para. 0.09 12

Para. 7.17 11

Para. 7.18 16

Para. 7.19 ..... 11, 16

Para. 7.21 11

Levinson, Administrative Procedures in Connection With Investigations and Hearings Under the Securities Act of 1933, Securities Laws and Regulations, 1967 Institute, Univ. of Miami Law Center at p. 109 14

Reports:

House Report No. 1409 on H. R. 8046, 75th Cong., 1st Sess. (1937) 10

Rules:

17 C. F. R. § 203.2 13

17 C. F. R. § 203.5 14

17 C. F. R. § 230.122 13

17 C. R. F. § 240.0-4 13

TABLE OF CITATIONS (Continued).

Statutes:

	Page
Bankruptcy Act, Chapter X, 11 U. S. C. § 501 et seq.:	
Section 167 (11 U. S. C. § 567)	2, 3, 4, 5, 7, 8, 9, 10, 11, 16, 17
Section 172 (11 U. S. C. § 572)	12
Section 208 (11 U. S. C. § 608)	10
Securities Act of 1933, Section 20(a), 15 U. S. C. § 77t(a)	4, 13
Securities Exchange Act of 1934, Section 21(b), 15 U. S. C. § 78u(b)	4, 13
28 U. S. C. § 1254, 62 Stat. 928 (1948)	2

IN THE

Supreme Court of the United States

OCTOBER TERM, 1968.

No.

IN THE MATTER OF

COMMONWEALTH FINANCIAL CORPORATION AND ITS SUBSIDIARIES, NEIGHBORHOOD FINANCE CO., INC. AND NEIGHBORHOOD FINANCE CO., INC. OF PENNSYLVANIA,

Debtors,

MORISE THAL,

Appellant.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Morise Thal prays that a Writ of Certiorari issue to review the affirmance by the United States Court of Appeals for the Third Circuit of an Order of the bankruptcy Court of March 19, 1969 entered March 21, 1969 in the above entitled case.

CITATIONS TO OPINIONS BELOW.

The opinion of the District Court of the Eastern District of Pennsylvania is reported at 288 F. Supp. 786 (1968). The opinion of the Court of Appeals for the Third Circuit is attached hereto in the Appendix. It has not yet been reported.

JURISDICTION.

The Judgment of the Court of Appeals of the Third Circuit was made on March 19, 1969 and an order was entered on March 21, 1969. The jurisdiction of this Court is invoked under 28 U. S. C. § 1254, 62 Stat. 928 (1948).

QUESTIONS PRESENTED.

1. Whether the District Court, in a Chapter X reorganization proceeding under the Bankruptcy Act, has the discretion to permit the Securities and Exchange Commission to participate, directly or indirectly, in a public examination of officers and directors of debtor corporations under Section 167 of the Bankruptcy Act.

2. If so, whether the District Court abused its discretion in permitting the Commission to so participate where the Commission is concurrently conducting a non-public investigation of such corporations to determine whether criminal violations of the Federal Securities Acts have been committed by such officers and directors.

3. If so, whether the District Court abused its discretion in permitting the Commission to so participate, especially in Appellant's examination, and in denying Appellant's motion for a protective Order where:

(a) Appellant has already testified in that non-public investigation, is subject to criminal prosecution under the Federal Securities Acts;

(b) The Commission announces its intention to examine appellant specifically on "Violations of the Federal Securities Laws" although a Section 167 examination relates to matters relevant to the desirability of the continuance of the debtor's business and/or formulation of a reorganization plan; or

(c) (1) The trustees have admitted that they and the Commission have "cooperated" with each other notwithstanding that the disclosure of information and documents obtained by the Commission in its non-public investigation are by law confidential and cannot be disclosed; and

(2) Appellant has alleged and the Commission has not denied that the Commission has divulged and, in the Section 167 examination, necessarily will divulge to unauthorized persons, including the trustees, such information and documents obtained by the Commission in its non-public investigation.

STATEMENT OF THE CASE.

This is an appeal from a Judgment of February 24, 1969 of the Circuit Court of Appeals for the Third Circuit affirming an Order of the United States District Court for the Eastern District of Pennsylvania entered on July 11, 1968, in a corporate reorganization proceeding (Proceeding) under Chapter X of the Bankruptcy Act, (a) directing appellant, Morise Thal, to be sworn and to testify as a witness in such depositions as may be scheduled by the trustees pursuant to Section 167 of the Bankruptcy Act, and (b) denying appellant's motion for a protective order.

On December 4, 1967, the debtor corporations filed a petition in the District Court for the Eastern District of Pennsylvania for a corporate reorganization pursuant to Chapter X of the Bankruptcy Act, 11 U. S. C. § 501 et seq.

Prior to the institution of the Proceeding, the Securities and Exchange Commission (Commission) had commenced and is still conducting a separate non-public investigation into the affairs of the debtors under the provisions of Section 20(a) of the Securities Act of 1933, 15 U. S. C. § 77t(a), and Section 21(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78u(b), to determine whether violations of these Acts have occurred. (These acts provide for criminal prosecution.) In the course of the non-public investigation, the appellant, who is subject to criminal prosecution, was examined by the Commission pursuant to a subpoena on March 5, 1968, and he remains subject to recall as a witness in that investigation.

By order entered March 20, 1968 in this Proceeding, upon petition of the trustees, the Honorable John Morgan Davis of the Federal District Court granted the trustees leave to investigate the "acts, conduct, property, liabilities and financial condition of the debtors", such investigation to include an examination of the "directors and officers of the debtors", pursuant to Section 167 of the Bankruptcy

Act, 11 U. S. C. § 567. Said Order was amended on May 23, 1968 to authorize examination by deposition.

On March 21, 1968, the First Interim Report of Trustees was filed in the District Court. The Report described, *inter alia,* the working relationship between the trustees and representatives of the Commission:

> "Conferences have been held with representatives of the Securities and Exchange Commission, who have entered their appearance and become a party to these proceedings. The Trustees have endeavored to extend full cooperation to the Securities and Exchange Commission, and in return have received helpful suggestions in the administration of the Debtor's estate.
>
> "The court is hereby advised that, apart from the normal participation in this proceeding of the Reorganization Section of the Securities and Exchange Commission located in New York, representatives of the investigatory division of the Securities and Exchange Commission in Washington have been conducting an investigation into the affairs of the Debtors for several months. The Trustees have extended their cooperation in this investigation by permitting the Securities and Exchange Commission access to the books and records of the Debtors."

Subsequently, on March 29, 1968, the trustees filed a petition for an order authorizing the Commission to participate in the Section 167 examination, averring that the petition was filed upon request of the Commission, and that such participation would assist the trustees in their investigation. On the same day Judge Davis entered the requested Order *ex parte.*

On June 6, 1968, the trustees filed their notice to take the oral deposition of appellant on June 13, 1968.

At that scheduled examination, counsel for the Commission were prepared to examine appellant on matters involving "violations of the Federal Securities laws including, but not limited to, the Securities Act of 1933 and the Securities and Exchange Act of 1934." No reference was made by counsel for the Commission to any other type of statute.

Also present at the examination and privy to discussions between counsel for the trustees and counsel for the Commission, with regard to the acceptability of the aforesaid proposal of counsel for appellant, was James Kennedy, Esquire, an attorney employed by the Regional Office of the Commission in Washington, D. C. and engaged in the non-public investigation in which appellant was examined as a witness. Following objections by counsel for appellant to any consultation between counsel for the trustees and counsel for the Commission or any of its attorneys in connection with the deposition, counsel for the Commission declared: "I would also like to state that there is no evidence before us today that Mr. Kennedy has consulted with either the Trustee or his representative or counsel that are representing the Commission. I made no representation whether he has or has not."

On or about June 17, 1968, the trustees filed a motion directly with Judge Davis seeking an order directing appellant to be sworn and to testify. On June 18, 1968, the Court entered an Order directing that the motion be heard on June 21, 1968, and directing counsel to file memoranda by 12:00 o'clock noon of June 20, 1968.

On June 20, 1968, appellant filed an amended motion for protective order, seeking a stay of his deposition or other examination under Section 167 of the Bankruptcy Act, and an answer to the trustees' motion. Appellant's answer contained an additional motion for further relief seeking, in the alternative, a stay of appellant's examination until further order of the Court or until appellant had

an opportunity to depose counsel for the Commission and counsel for the trustees to determine the extent to which information obtained by the Commission in the aforesaid non-public investigation has been or will be disclosed to the trustees or their counsel or the Commission's counsel in this case. Appellant's motions were made on the ground that participation in the Section 167 examination by attorneys for the Commission would be a violation of the Commission's own rules and of federal regulations, concerning, *inter alia*, the confidentiality of the non-public investigation, and would greatly prejudice appellant both in the non-public investigation and the Section 167 proceeding.

On June 21, 1968, the District Court heard argument on the trustee's motion and appellant's motions for a protective order and, on July 11, 1968, filed an Opinion and Order directing appellant to be sworn and to testify as a witness.

Appeal was taken to the Court of Appeals for the Third Circuit. The appeal was argued on January 20, 1969 and the Order of the District Court was affirmed on February 24, 1969 in a per curiam opinion.

REASONS FOR GRANTING THE WRIT.

1. Philosophically there is a conflict bewteen two Circuit Courts of Appeals on the subject involved in this case. In Securities and Exchange Commission v. Honorable George Templar, No. 10114 decided by the Tenth Circuit Court of Appeals on January 3, 1969 that Court decided that the law relating to reorganization proceeding does not give the "Commission superior rights to other parties." In the instant case the Court "authorized the Commission to participate in the Section 167 examination of witnesses" and therefore did give the Commission superior rights to any other party. We respectfully submit that the contrary legal position of the two Circuit Courts should be resolved by the Supreme Court.

2. The instant case presents squarely for decision for the first time the right of the Securities and Exchange Commission to participate in examination under Section 167 of the Bankruptcy Act. The permission granted by the District Court and affirmed by the Circuit Court in this matter seems to be contrary to the trend of civil rights and liberties presently extended by all Courts of the United States. Disregarding all of the technicalities involved, the net effect of the decision of the lower court in this instance is to give the Commission an avenue of discovery and exploration that was not granted to it by Congress and to the detriment of the fair treatment of officers and employees of a debtor corporation.

3. The Circuit Court has interpreted the provision of the Banktruptcy Act which permits the Commission to become a party in interest with the right "to be heard" as including the authority to participate in the questioning which is intended primarily for the benefit of the trustees. The decision goes far beyond the bounds of reason.

4. The District Court, in a Chapter X reorganization proceeding under the Bankruptcy Act, does not have the discretion to permit the securities and exchange commission to participate in an examination under section 167 of the Bankruptcy Act.

A. Section 167 of the Bankruptcy Act Does Not Authorize the District Court to Allow Any Party, Other Than a Trustee Who Cannot Delegate Such Duty, to Conduct an Examination of Officers and Directors of the Debtor Corporation.

The District Court clearly has the discretion to permit the trustee to examine directors and officers of the debtor and other witnesses. Section 167(2) of the Bankruptcy Act (Act) (11 U. S. C. Sec. 567(2)) provides:

> "The Trustee upon his appointment and qualification—(2) may, if the judge shall so direct, examine the directors and officers of the debtor and any other witnesses concerning the foregoing matters or any of them [Sec. 567(1)]."

Subsection 1 of that Section provides:

> "The trustee upon his appointment and qualification—(1) shall, if the Judge shall so direct, forthwith investigate the acts, conduct, property, liabilities and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, and any other matter relevant to the proceeding or to the formulation of a plan, and report thereon to the judge."

Thus, by statute, the trustee may be given the authority to conduct depositions but, as the lower Court admits in its

Opinion, the Act does not authorize Commission participation therein. The lower Court, however, bases its right to authorize such participation upon subsection 4 of Section 167 of the Act:

> "The Trustee upon his appointment and qualification—(4) may, subject to the approval of the judge, employ such person or persons as the judge may deem necessary for the purpose of *assisting* the trustee in performing the duties imposed upon him under this Chapter." (Emphasis supplied.)

The lower Court thought that the issue then is whether subsection 4 of Section 167 contemplates the "employment" of the Commission for the purpose of participating in a 167 examination and concludes that such so-called employment is discretionary with the Court. That Court and the trustees did not and cannot cite any precedent for such conclusion. The cases cited do not support the conclusion.

First, the trustees are obviously not employing the Commission. Second, the trustees have no intention of merely allowing the Commission to "assist"—the Commission has already directly participated in the attempted examination of appellant. Third, Section 208 of the Act (11 U. S. C. Sec. 608) which permits the Commission to intervene, allows it only the right to be *heard* on all matters, not the right to *examine* any witness. If Congress had intended that the Commission should have such right, surely it would have so provided.

COLLIER describes the role of the Commission as "advisory". COLLIER ON BANKRUPTCY, Vol. 6, 14th Ed., Para. 0.08(3) at p. 96. More important is the description found in House Report No. 1409 on H. R. 8046, 75th Cong., 1st Sess. (1937) at p. 48:

> "Another important feature of the bill is the provision vesting the Securities and Exchange Commission with *advisory* power in reorganizations. Its functions will be those, so to speak, of an expert, administrative agency, which acts in an *advisory* capacity to the Court and thus indirectly to interested parties in the reorganization." (Emphasis supplied.)

There is no indication whatsoever in any Congressional Report that it ever intended anyone, other than the trustee, to examine witnesses pursuant to Section 167.

The only conceivable right that the Commission may have concerning a 167 examination is to petition the Court that such examination be conducted by the trustee. As stated in Para. 7.19(1), Vol. 6, 14 Ed. of COLLIER ON BANKRUPTCY at p. 1221:

> "Although ordinarily it will be the trustee who will seek the judge's authorization of an examination under Sec. 167(2) there is nothing to prevent any party in interest from petitioning the judge for an order that the trustee undertake an examination."

Further, it is clear that subsection 4 of Section 167 contemplates the hiring of persons such as those who can assist in running the debtor's business, those who can assist in preparing financial statements and those who can assist in appraising the value of the debtor's property, all of whom are hired because of certain expertise in their respective areas. See COLLIER ON BANKRUPTCY, Vol. 6, 14th Ed., Para. 7.21 at pp. 1229-32.

It is thus clear that:

> "The duty to conduct such preliminary investigation falls upon the disinterested trustee . . ." COLLIER ON BANKRUPTCY, Vol. 6, 14th Ed., Para. 7.17, at p. 1208;

and

> "The position of the Commission in reorganization proceedings is in effect that of an *amicus curiae*—a disinterested and expert agency whose function it is to aid in the efficient and fair functioning of the reorganization process." COLLIER ON BANKRUPTCY, Vol. 6, 14th Ed., Para. 0.09, at p. 105.

Moreover, in a Chapter X proceeding the Court *must* (rather than may in this case since the debts exceed $3,000,000) under Section 172 of the Bankruptcy Act (11 U. S. C. § 572) submit to the Commission for examination the proposed plan of reorganization. The Court thereafter cannot approve such plan until the Commission files a report thereon, notifies the Court it will not file a report or until expiration of the time fixed for filing such report has occurred. Thus, the role of the Commission is clearly to be an independent advisor to the Court and precludes the conflicting roles of assistant or employee of the trustees.

B. Assuming, Arguendo, the District Court Has Such Discretion, the District Court Abused That Discretion Since the Commission Under the Federal Securities Laws Was and Is Presently Conducting a Non-Public Investigation of the Debtor Corporations to Ascertain Whether Criminal Violations of Such Laws Have Occurred.

1. Once the Commission has determined to conduct a non-public rather than public investigation of a corporation, it cannot participate directly or indirectly in a public examination of such corporation until such time that the Commission authorizes a public investigation.

Prior to the institution of the Proceedings and continuing to date, the Commission is conducting a *non-public*

investigation of the debtor corporations pursuant to Section 20(a) of the Securities Act of 1933, 15 U. S. C. § 77t(a), and Section 21(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78u(b). The violations of those Acts call for *inter alia*, severe criminal penalties including fines and/or imprisonment.

A non-public Commission investigation is what its terms suggest—confidential. Rule 122 promulgated under the Act of 1933, 17 C. F. R. § 230.122, and Rule 0-4 promulgated under the Act of 1934, 17 C. F. R. § 240.0-4, are virtually identical and provide, *inter alia*, the following:

> "Information or documents obtained by officers or employees of the commission in the course of any examination or investigation pursuant to Section 17(a) or 21(a) [under the 1934 Act and Section 8(e) or 20(a) under the 1933 Act] shall, unless made a matter of public record, be deemed confidential. Officers and employees are hereby prohibited from making such confidential information or documents or any other non-public records of the Commission available to anyone other than a member, officer or employee of the Commission, unless the Commission authorizes the disclosure of such information or the production of such documents as not being contrary to the public interest."

and

The Commission's own "Rules Relating to Investigation" provide:

> "Information or documents obtained by the commission in the course of any investigation or examination, unless a matter of public record, shall be deemed non-public." Rule 2, 17 C. F. R. § 203.2.

> "Unless otherwise ordered by the Commission, all formal investigative proceedings shall be non-public." Rule 5, 17 C. F. R. § 203.5.

Significantly, the Procedure in *public* investigations differ markedly from that of the aforesaid non-public investigation.

Thus, in a non-public investigation, hearings are private and any information, including documents, obtained in such proceeding is confidential to protect the privacy and rights of parties. See, LEVINSON, ADMINISTRATIVE PROCEDURES IN CONNECTION WITH INVESTIGATIONS AND HEARINGS UNDER THE SECURITIES ACT OF 1933, Securities Laws and Regulations, 1967 Institute, Univ. of Miami Law Center at p. 109.

The Commission has already elected to take the non-public route in investigating the debtor corporations. Now the Commission wishes to again examine the corporation, this time at a public hearing in a Bankruptcy proceeding where the testimony of a witness is not protected by confidentiality and such witness has neither the protection of cross-examination nor the right to produce evidence on his own behalf.

In effect, the Commission now, after gleaning information which is deemed confidential by law, wishes to publicly examine the corporation without affording those rights which the Commission must give to all witnesses in its own public investigation.

The Commission, of course, has the discretion of deciding whether to investigate the subject corporation privately or publicly. But once an administrative agency, such as the Commission herein, does make its choice, it

cannot directly or indirectly avoid the procedural rules governing that choice—it must comply with and abide by its own rules. *Elmo Division of Drixe-X Company v. Dixon,* 348 F. 2d 342, 345-46 (D. C. Cir. 1965).

Where, as here, the Commission will act in such contravention of its own rules, the courts will intervene and give relief. *R. H. Macy & Company, Inc. v. Tinley,* 249 F. Supp. 778, 782 (D. D. C. 1966).

C. Assuming, Arguendo, the District Court Has Such Discretion, the District Court Abused That Discretion.

1. Since appellant has already testified in the non-public investigation and is subject to criminal prosecution, the Commission should not be allowed to again examine him in a public examination without affording him the rights and protection to which appellant is entitled by law under a public investigation conducted by the Commission.

As demonstrated above, the rules relating to non-public Commission investigations clearly protect any information obtained thereby as confidential; and the rules relating to public investigations clearly afford any witness with at least the right to be present when testimony or other evidence is given concerning the witness, the right of cross-examination and the right to offer testimony and other forms of evidence, all of which rights were not and are not available to appellant in the Commission's non-public investigation of the subject corporations.

2. The purpose of a Section 167 examination is to evaluate the desirability of the continuance of the Debtor's business and/or to formulate a plan of reorganization, not as the Commission intends, to determine whether appellant has violated Federal Securities Laws.

The purpose of a 167 Examination is to assist the trustee in *his own* investigation of the debtor corporation in order to determine whether the business should be continued and to formulate a plan of reorganization. *Collier on Bankruptcy,* Vol. 6, 14th Ed. Paras, 7.18, 7.19, at pp. 1210-1221. Nowhere in the Act is the trustee, let alone the Commission, given the specific right to examine any witness as to violations of federal securities law. That line of inquiry is obviously without the scope of the statutory examination. However, the record of the District Court is clear that the Commission desires to utilize the examination as a fishing expedition for Securities Acts violations.

3. Since the Trustees have already admitted that the Commission is cooperating with them and appellant has alleged and the Commission has not denied that the Commission has divulged, and in the course of a Section 167 examination, necessarily will divulge to unauthorized persons, including the Trustees, confidential information, documents and lines of inquiry, obtained by the Commission in its non-public investigation, the divulgence of which is contrary to law, the Commission should not be allowed to participate in the public examination of appellant.

The only conceivable remedy to avoid this unlawful disclosure of confidential information by the Commission is for this Court to absolutely preclude the Commission from participating in any way in the deposition of appellant.

CONCLUSION.

It is respectfully submitted that the order of the District Court authorizing the Securities and Exchange Commission to participate in the Section 167 examination is a violation of civil rights, constitutional liberties and is basically unreasonable. For the reasons stated it is respectfully requested that this petition for a writ of certiorari be granted.

Respectfully submitted,

ALBERT B. GERBER,
1512 Walnut St.,
Phila., Pa.,
Attorney for Petitioner.

APPENDIX.

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT.

No. 17455.

IN THE MATTER OF:
COMMONWEALTH FINANCIAL CORPORATION
AND ITS SUBSIDIARIES,
NEIGHBORHOOD FINANCE CO., INC., AND
NEIGHBORHOOD FINANCE CO., INC.
OF PENNSYLVANIA

MORISE THAL, PRESIDENT OF THE DEBTORS CORPORATIONS,
Appellant.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

Argued January 20, 1969

Before HASTIE, *Chief Judge*, and MCLAUGHLIN and STAHL, *Circuit Judges*.

OPINION OF THE COURT.

(Filed February 24, 1969.)

PER CURIAM.

The present controversy has arisen during the course of a corporate reorganization proceeding under Chapter X of the Bankruptcy Act. The Securities and Exchange Com-

mission became a party to this proceeding, as authorizing by section 208 of Chapter X, 11 U.S.C. § 608, by filing and obtaining the court's approval of its notice of appearance. Subsequently, the court authorized the trustees to conduct an examination of witnesses, including officers and directors of the debtor, as provided in section 167. 11 U.S.C. § 567. Thereafter, on petition by the trustees, the court authorized the Commission to participate in the section 167 examination of witnesses.

The trustees called the appellant, who is president of the debtor corporation, for examination. He refused to be sworn or to testify because of the Commission's intention to participate. The matter was submitted to the court which rejected the excuse and ordered the witness to testify. This appeal was then taken to test the right of the Commission to participate in the examination of the appellant.

Section 208 provides that after the Commission's request to appear shall have been approved by the court, "the Commission shall be deemed to be a party in interest, with the right to be heard on all matters arising in such proceedings. . . ." The Court of Appeals for the Fifth Circuit has recently construed this section as authority for the examination of witnesses by the Commission at a hearing to determine whether certain shareholders should be deprived of their stock. *Securities and Exchange Comm. v. Krentzman,* 1968, 397 F.2d 55. And see *Securities and Exchange Comm. v. Templar,* 10th Cir. 1969, — F.2d —, 37 U.S.L.W. 2406. We find no canon of interpretation and no reason or policy that would dictate a narrower interpretation to make section 208 inapplicable in the present context. We note in this regard that in this case both the court and the trustees have approved the participation of the Commission in the section 167 examination.

It is suggested that information obtained by the Commission through its examination of the appellant might later be used against him in a related criminal proceeding. Of course the same danger would be inherent in examination by the trustees. However, in either event the witness is free to resist examination by asserting his privilege against self-incrimination. This the appellant has not done.

The order requiring the appellant to be sworn and to testify as a witness will be affirmed.

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT.

No. 17455.

IN THE MATTER OF:
COMMONWEALTH FINANCIAL CORPORATION
AND ITS SUBSIDIARIES,
NEIGHBORHOOD FINANCE CO., INC., AND
NEIGHBORHOOD FINANCE CO., INC.
OF PENNSYLVANIA

MORISE THAL, PRESIDENT OF THE DEBTORS CORPORATIONS,
Appellant.

ORDER SUR PETITION FOR REHEARING.

Present: HASTIE, *Chief Judge*, and KALODNER, FREEDMAN, SEITZ, VAN DUSEN, ALDISERT and STAHL, *Circuit Judges.*

The petition for rehearing filed by MORISE THAL, President of the debtors corporations, Appellant in the above entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By THE COURT,
(Sgd.) WILLIAM H. HASTIE, *Chief Judge*

Dated: March 19, 1969

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT.

No. 17455.

IN THE MATTER OF:
COMMONWEALTH FINANCIAL CORPORATION
AND ITS SUBSIDIARIES,
NEIGHBORHOOD FINANCE CO., INC., AND
NEIGHBORHOOD FINANCE CO., INC.
OF PENNSYLVANIA
MORISE THAL, PRESIDENT OF THE DEBTORS CORPORATIONS,
Appellant.
(D. C. No. 30108 in Bankruptcy)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Present: HASTIE, *Chief Judge* and MCLAUGHLIN and STAHL, *Circuit Judges.*

JUDGMENT.

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the order of the said District Court requiring the appellant to be sworn and to testify as a witness, filed July 11, 1968, be, and the same is hereby affirmed, with costs.

ATTEST:
THOMAS F. QUINN, *Clerk.*

February 24, 1969

IN THE

UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

IN PROCEEDINGS FOR THE REORGANIZATION OF A CORPORATION UNDER CHAPTER X OF THE BANKRUPTCY ACT.

CAUSE NO. 30108.

IN THE MATTER OF

COMMONWEALTH FINANCIAL CORPORATION AND ITS SUBSIDIARIES, NEIGHBORHOOD FINANCE CO., INC. AND NEIGHBORHOOD FINANCE CO., INC. OF PENNSYLVANIA,

Debtors.

OPINION.

DAVIS, *J.*

Under authority of Section 167 of the Bankruptcy Act, 11 U. S. C. § 567, the trustees in this Chapter X proceeding were granted leave to investigate the "Acts, conduct, property, liabilities and financial condition of the debtors", to include an examination of the "directors and officers of the debtors."[1] Subsequently, the Securities and Exchange Commission (S. E. C.) was authorized to participate and assist in the aforementioned investigation.[2]

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1. See Petition of Trustees for Order Directing Investigation of Debtors and Examination of Witnesses Under Section 167 (document 34), entered on March 21, 1968. This Order was subsequently amended on May 23, 1968, to authorize examinations by way of depositions (document 45).

2. See Petition of Trustees for Order Authorizing the Securities and Exchange Commission to Participate in Examination (document 41), filed on March 29, 1968.

We have since been apprised by the petitioner that the S. E. C. has apparently been conducting a separate and independent investigation of the affairs of the debtors, under the provisions of Section 20(a) of the Securities Act of 1933,[3] and Section 21(b) of the Securities Exchange Act of 1934.[4] This investigation has included an examination of the petitioner (by his own assertion) pursuant to "continuing subpoena" by the S. E. C. We shall assume, *arguendo,* that the petitioner may be recalled by the S. E. C. either concurrent with, or subsequent to the trustees' Section 167 investigation. It is possible that the petitioner may be subjected to criminal prosecution if the S. E. C. investigation would indicate that such action is appropriate.[5] At this time, however, there has been no criminal proceeding instituted against the petitioner; this opinion will be predicated upon that premise.

---

3. 15 U. S. C. § 77t(a), which states, in relevant part:

Whenever it shall appear to the Commission . . . that the provisions of this subchapter [domestic] securities . . . have been or are about to be violated, it may . . . require such person to file . . . a statement . . . under oath . . . as to all the facts and circumstances . . . .

4. 15 U. S. C. § 78u(b), which states, in relevant part:

For the purpose of any such investigation, [securities exchanges] . . . the Commission . . . is empowered to . . . subpoena witnesses, compel their attendance, take evidence and require the production of any books, papers, correspondence . . . .

5. 15 U. S. C. § 77x states, in relevant part:

Any person who wilfully violates any of the provisions of this subchapter [Securities] . . ., or any person who wilfully in a registration statement filed under this subchapter, makes any untrue statement of a material fact, or omits to state any material fact . . . shall upon conviction be fined not more than $5,000 or imprisoned not more than five years, or both.

See also 15 USC § 78ff(a) providing a maximum of $10,000 fine and/or two years imprisonment for wilful violation of securities exchange regulations, or for filing false registration statements.

After receiving written notice of depositions by the Chapter X trustees (with participation by the S. E. C.),[6] the petitioner, Morise Thal, president of the debtor corporations,[7] filed the motion for a protective order presently before the Court,[8] seeking a stay of any further attempts to depose or otherwise examine him by the trustees, during the pendency of the S. E. C. investigation.

I.

Preliminarily, the petitioner is contesting the authority of the S. E. C. to participate in an investigation ostensibly conducted under Section 167 of the Bankruptcy Act. It is true that the Act does not expressly authorize S. E. C. participation in the Section 167 investigation. However, this section clearly states that the trustees . . .

> may, subject to the approval of the judge, employ such person or persons as the judge may deem necessary for the purpose of assisting the trustee in performing the duties imposed upon him under this chapter.

Having just obtained the requisite leave of court, *In Re Flamingo Hotel Co.*, 81 F. 2d 749 (7th Cir. 1936), the only question remaining is whether this statute contemplates the "employment" (albeit without compensation) of the S. E. C.

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6. Written notice was tendered to the petitioner on June 6, 1968 (document 48).

7. The petition for reorganization filed December 4, 1967 was signed by Thal as president of the principal and 2 subsidiary debtor corporations. On January 29, 1968, Thal was retained by the trustees as "Chief Operating Officer" (document 10).

8. On June 13, 1968, an effort was made by the trustees to depose Thal. However, he refused to be sworn, apparently on advice of his counsel. Subsequently, the trustees filed a "Motion of Trustees for Order Directing Witness to be Sworn and to Testify", which is also presently before the Court (document 55).

for the purpose, *inter alia* of assisting in a Section 167 investigation.

Under Section 208 of the Bankruptcy Act, 11 U. S. C. § 608, the S. E. C. if approved by the Court, is given the right to proceed as a party in interest "with a right to be heard in all matters . . ." In *In Re Otis & Co.*, 104 F. Supp. 201, 203 (N. D. Ohio, 1952), it was observed that Congress, by authorizing participation by the S. E. C. in a Chapter X reorganization:

> ". . . intended material assistance between the Court and the Commission and that to insure harmony the grants of power alluded to above [Sections 172 and 208 participation] were intended to subject the Securities and Exchange Commission to the orders of a reorganization court. . . .

If the court is statutorily vested with discretion 1), to authorize participation *generally*, under Section 208, and 2), to limit S. E. C. participation *specifically* when deemed necessary, *In Re Otis*, supra, and cases cited therein, it follows that the Court has sufficient authority to permit S. E. C. participation for particular aspects of a Chapter X reorganization, such as the Section 167 investigation at issue. In so holding, however, we wish to reemphasize that participation is discretionary with the Court *In Re Morris White Properties Corp.*, 21 F. Supp. 635 (E. D. N. Y. 1937). Since abuse of that discretion has not been established or even alleged, participation by the S. E. C. in the contemplated section 167 investigation will be permitted.

II.

Turning to the merits of petitioner's motion, we agree that it is quite possible that the scope of the S. E. C. investigation may, to some extent, encompass the same subject

matter as the Section 167 investigation conducted under the auspices of the trustees. Both statutes essentially contemplate to some extent, the devolution of fraudulent practices by persons in control and operation of the debtor corporation.[9] Parenthetically, we observe that the S. E. C. apparently shares this view, since the petitioner was recently warned by its counsel that:

> . . . as a witness . . . the facts developed in these proceedings conducted by the trustees . . . may constitute violations of the Federal Securities laws including but not limited to the Securities Act of 1933 and Exchange Act of 1934. . . . Since any evidence you give could be used against you, you may refuse to give any testimony.[10]

III.

Unless the contemplated Section 167 deposition is stayed, the petitioner asserts that his privilege against self-

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9. For example Section 17(a) of the Securities Act of 1933, 15 U. S. C. § 77q(a) states, in relevant part, that:

> It shall be unlawful for any person in the offer or sale of any securities . . . directly or indirectly—
>
> (1) to employ any device, scheme or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact . . . or
>
> (3) to engage in any transaction . . . which operates . . . as a fraud or deceit upon the purchaser.

By comparison, Section 167 of the Bankruptcy Act, 11 U. S. C. § 567 requires the trustees, pursuant to their investigation, to ". . . report to the judge any facts ascertained by him [trustee] pertaining to fraud, misconduct, mismanagement and irregularities, and to any causes of action available to the [debtor's] estate." The scope of the Section 167 investigation is rather comprehensive, and includes ". . . the acts, conduct, property, liabilities and financial condition of the debtor, the operation of its business . . . and any other matter relevant to the proceeding . . .", including authority to ". . . examine the officers and directors of the debtor . . ."

10. Oral deposition of Morise Thal, June 13, 1968, p. 6 (document 56).

incrimination under the 5th Amendment to the Constitution will be infringed. This assertion is further developed by hypothesizing that the S. E. C. is empowered to grant "full constitutional immunity." from the imposition of any penalty in connection with the S. E. C. investigation,[11] but that no such arrangement is available under Chapter X of the Bankruptcy Act. Thus, it is asserted that the S. E. C. could conceivably play one investigation against the other, eliciting (and utilizing in a criminal proceeding) information which would otherwise be immune pursuant to the statutes cited in footnote 11, below. We do not agree. While it is true that no comparable statutory immunity may be offered by the trustees during the Section 167 investigation, the petitioner is always free to assert his 5th Amendment right against self-incrimination at any time. The privilege may be asserted in any proceeding," . . . be it criminal or civil, administrative or judicial, investigatory or adjudicatory." *United States v. Goldsmith,* 272 F. Supp. 924, 926 (E. D. N. Y. 1967), citing *Murphy v. Waterfront Commission,* 378 U. S. 52, 94 (1964).

Nor would the privilege against self-incrimination extend only to matters which are directly related to the ultimate objective of the trustees' investigation, namely, to effect an equitable reorganization. The petitioner may assert his 5th Amendment rights to protect himself from ". . . any disclosures which . . . [he] may reasonably apprehend could be used in a criminal prosecution or which

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11. Section 22 of the 1933 Act, 15 U. S. C. § 77v(c), pertaining to securities, states in relevant part:

> No person shall be excused from attending and testifying . . . on the ground that the testimony . . . may tend to incriminate him . . ., but no individual shall be prosecuted . . . concerning which he is compelled after having claimed his privilege against self incrimination to testify.

See also Section 21 of the 1934 Act, 15 U. S. C. § 78u(d), which provides for a similar provision regarding securities exchanges.

could lead to other evidence that might be so used." *Murphy,* supra, recently cited with approval in *Matter of Gault,* 387 U. S. 1 (1967). Armed with such protection, the petitioner neither needs, nor is constitutionally, statutorily or equitably entitled to the protective order which he now seeks.

IV.

The fact that a contemplated area of inquiry may be *potentially* incriminatory does not authorize or indeed require a blanket invocation of the privilege against self-incrimination:

> . . . it is not and has never been the law that the privilege disallows the asking of *potentially* incriminatory questions or authorize the person of whom they are asked to evade them without *expressly* asserting that his answers may tend to incriminate him (emphasis added).

Communist Party v. Subversive Activities Control Board, 367 U. S. 1, 108 (1961).

Recently, in *In Re Hoffman Can Corp.,* 373 F. 2d 622 (1967), the Third Circuit rejected a rather similar effort to invoke a blanket privilege against self-incrimination. In *Hoffman,* the officers of a bankrupt corporation refused to file a statement of affairs,[12] together with supporting schedules, claiming that certain responses contained therein may tend to be incriminating. In so deciding, the Third Circuit substantially relied upon *United States v. Sullivan,* 274 U. S. 259 (1927), a leading decision in the area of income tax law, where it was emphasized that:

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12. As required by Sections 7 to 9 of the Bankruptcy Act, 11 U. S. C. § 25-27.

> . . . a claim of self-incrimination against every question . . . would be virtually frivolous.

Although it is theoretically conceivable that the petitioner Thal may find every question objectionable when propounded, it is anticipated and indeed hoped that he has not become so deeply embroiled in questionable practices, that he need assert his 5th Amendment privilege to *each* and *every* question of the trustees.[13]

V.

Both sides have placed forceful reliance upon some facet of *United States v. Simon,* 262 F. Supp. 64 (S. D. N. Y. 1966), reversed, 373 F. 2d 649 (2nd Cir. 1967).[14]

In *Simon*, a judge of the Southern District of New York, before whom a *criminal* proceeding for mail fraud was pending, enjoined for a period of 90 days, the further deposing of defendants who had also been sued in a *civil* proceeding pending in the Eastern District of New York. The latter action was being prosecuted by Chapter X trustees, alleging that the common defendants had conspired to despoil assets of the debtor corporation, by *inter alia,* preparing and certifying false financial statements.[15]

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13. Nor would there be any obligation on the part of the trustees to refrain from directing inquiries to the petitioner because the answers may be incriminating. *United States v. Alaimo,* 191 F. Supp. 625, 630 (M. D. Pa. 1961) aff'd., 297 F. 2d 604 (3rd Cir. 1962) and cases cited therein.

14. Although reversed by the Second Circuit, Mr. Justice Harlan as Circuit Justice, stayed the execution and enforcement of the Circuit Court decree. Certiorari was granted, sub nom. *Simon v. Wharton,* 386 U. S. 1030 (1967), but subsequently vacated, as moot. 387 U. S. 425 (1968).

15. In the criminal proceeding pending in the Southern District, the defendants were charged with: mail fraud, 118 U. S. C. § 1341; filing false and misleading reports in violation of the S. E. C. Act of 1934, 15 U. S. C. § 78ff; and violation of an analogous provision of the Criminal Code, 18 U. S. C. § 1001.

Although *Simon* presented a factually stronger case for some form of protective order than the instant case, since the defendants had already been indicted in the criminal proceeding, the Second Circuit nonetheless decreed that additional protection was unnecessary:

> The fact that additional testimony thereby becomes available to the government is merely the natural by-product of another judicial proceeding; and to that extent it is not discovery . . .

The Court then continued:

> Indeed, the constitutional rights of the appellees are unimpaired; here they are in suspension because the appellees have not chosen to avail themselves of their Fifth Amendment privileges. *United States v. Simon, supra,* at p. 652.

We recognize that the reasoning manifested by the Second Circuit in *Simon* has been subjected to rather diverse interpretation. Compare e.g., *Philadelphia Housing Authority v. American Radiator & Standard Sanitary Corp.*, 269 F. Supp. 540 (E. D. Pa. 1967), with *United States v. American Radiator & Standard Sanitary Corp.*, 272 F. Supp. 691 (W. D. Pa. 1967) reversed, 388 F. 2d 201 (3rd Cir. 1967).[16] Whether any criminal action will ultimately be instituted is presently a matter of conjecture or, as best may be characterized as the professional opinion of the petitioner or his counsel. This is insufficient justification for the sweeping protection which the petitioner seeks.

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16. See *United States v. Birrell,* 272 F. Supp. 798, 810 (S. D. N. Y. 1967), where a criminal defendant unsuccessfully sought to enjoin Chapter X trustees from examining and otherwise making use of records and documents pertaining to the debtor corporations. Civil suits had also been commenced by the trustees against the defendant.

VI.

Finally, it is asserted that the trustees will not be prejudiced, since they are free to proceed with their investigation, and take the deposition of "any and all witnesses" (excepting only Thal). Absent the existence of any constitutional protection, this argument fails to consider the prominent position which Thal has held as former chief executive officer of the debtor corporation, and the immeasurable assistance which he is potentially capable of rendering in furtherance of an equitable reorganization of the debtor corporations.

In addition, there is no assurance (and indeed a strong indication to the contrary), that if the protective order were granted to Thal, all of the other "insiders" would not then assert a similar right to protection, thereby effectively blocking the progress of the Section 167 investigation. Also, any extended delay would seriously hamper the trustees in prosecuting in a timely manner, any causes of action which may be available to the estate for recoupment of assets, by reason of the statute of limitations, 11 U. S. C. § 29.

In *In re Mutual Security Savings & Loan Ass'n. Inc.*, 214 F. Supp. 877 (D. Md. 1963), it was stated that:

> The Court must not depart from the liberal respect of the privilege [against self incrimination] so well engrafted into American Jurisprudence, but an improvident honoring of the privilege in derogation of the rights of the numerous creditors . . . is to be avoided.

We emphatically agree with this observation.

ORDER.

AND NOW this 11th day of July 1968, it is HEREBY ORDERED that the petitioner Morise Thal is directed to be sworn and to testify as a witness in such depositions as may be scheduled by the trustees of the debtor corporations pursuant to Section 167 of the Bankruptcy Act. This Order is without prejudice to or in derogation of the rights of the petitioner to exercise any Constitutional privilege, in accordance with this Opinion and Order, which he may have.

IT IS FURTHER ORDERED that the petitioner's countermotion for a protective order is DENIED.

BY THE COURT:

JOHN MORGAN DAVIS, *J.*